Sovereign Debt Managers Forum

Breakout Session 1:

Market Dynamics in International Capital Markets for Sovereign Debt

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The World Bank

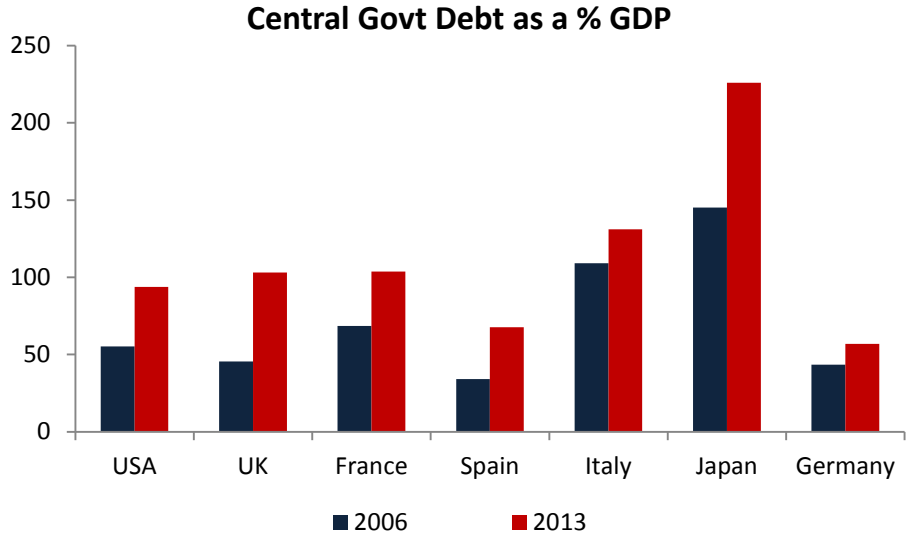
Outline

1. Global Developments
2. The Case: Sri Lanka
3. Final Remarks

1. Global Developments

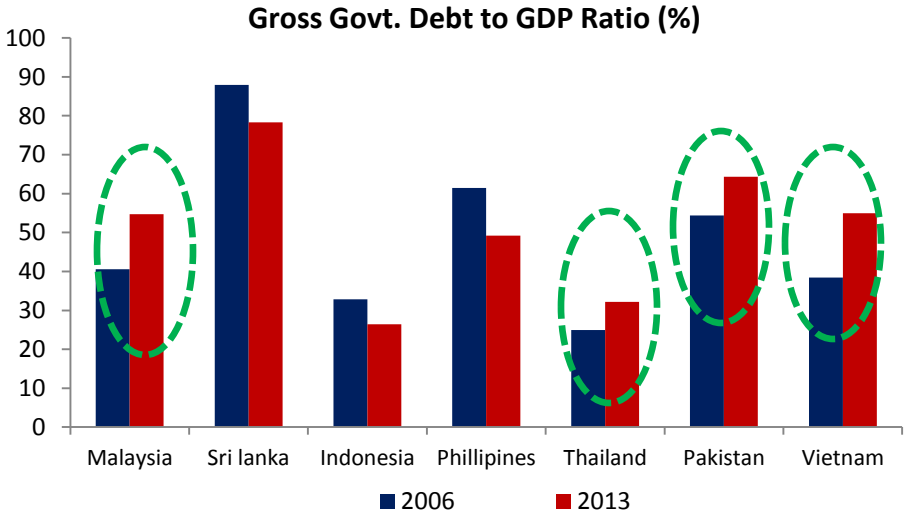
Sovereign Debt Managers are under tremendous stress after Global Financial Crisis….

- Advanced Economies



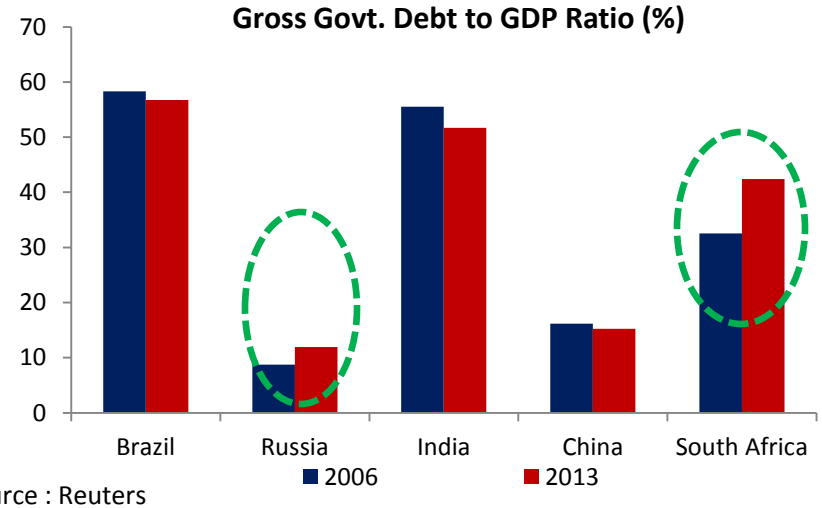
Source : World Bank

- Emerging Economies (Asia)



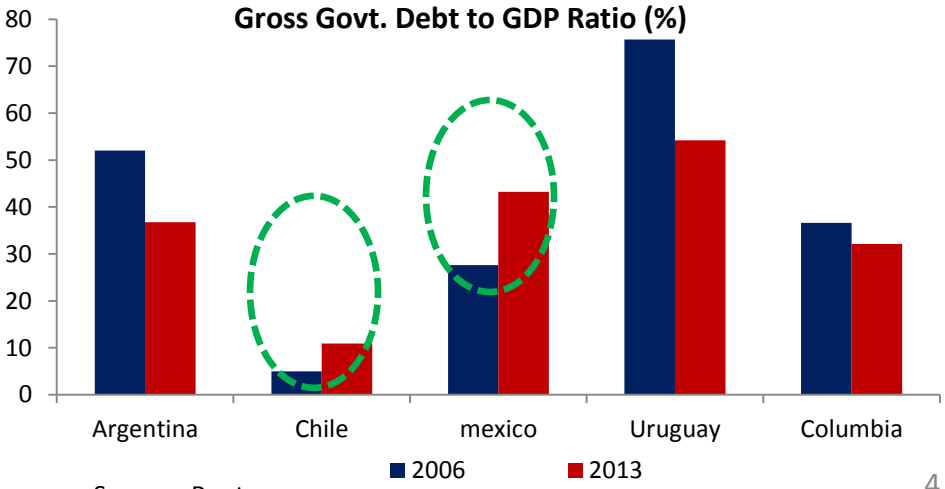
Source : Reuters

- BRICS Economies



Source : Reuters

- Emerging Economies – Latin America



Source : Reuters

Unconventional Monetary Policies pumping excessive funds into the international capital market…

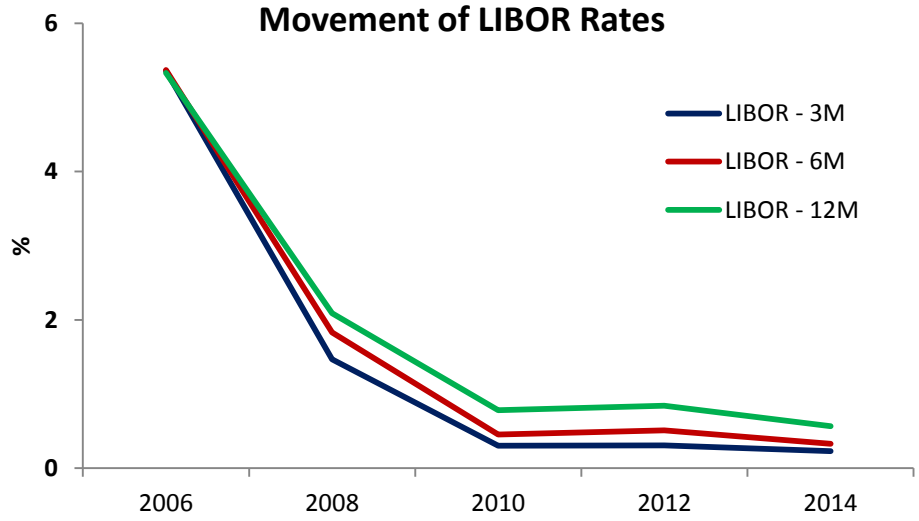
- USA – Quantitative Easing
  - **QE 1 (Dec 2008- June 2010)**
    - Fed's holding of agency mortgage-backed securities (MBS) and agency debt increased from US$ 800bn to US$ 2.1 trillion.
  - **QE 2 (from Aug 2010 – June 2011)**
    - Fed announced the purchase of $600 bn longer dated treasuries, at a rate of $75 bn per month
  - **QE 3 (From September 2012)**
    - Open-ended commitment to purchase mortgage-backed securities per month until the labor market improves "substantially". Started with US$ 40 bn per month and increased to US$ 85bn per month.
    - The Fed ended its monthly asset purchases program (QE3) in October 2014
- EU Area – Quantitative Easing
  - The ECB commenced purchasing covered bonds and is expected to purchase asset-backed securities of Euro 1 trillion.
- UK – Quantitative Easing
  - **March 2009 – January 2010**
    - Purchased around £165 bn in assets as of September 2009 and around £175 bn in assets by the end of October 2010.
  - **November 2010**
    - BOE increased total asset purchases to £200 bn
  - **October 2011 – July 2012**
    - Total amount of QE is around £375 bn

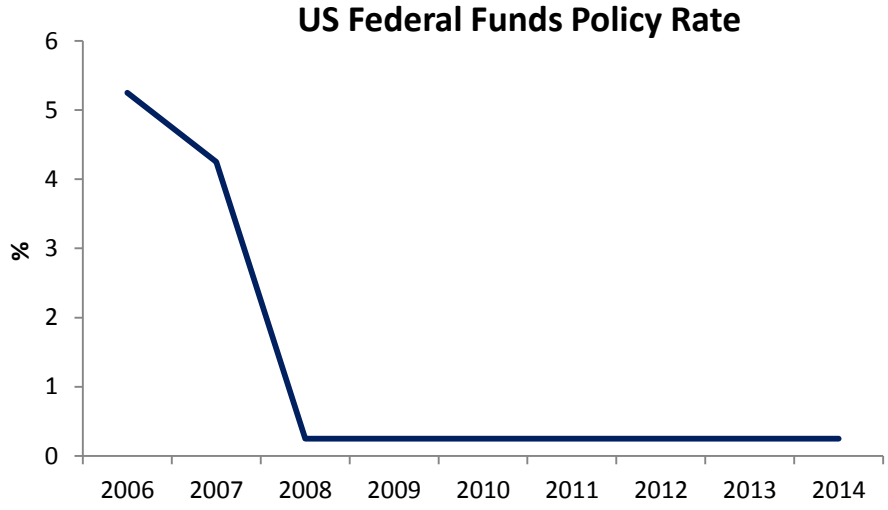
Unconventional Monetary Policies (cont…)

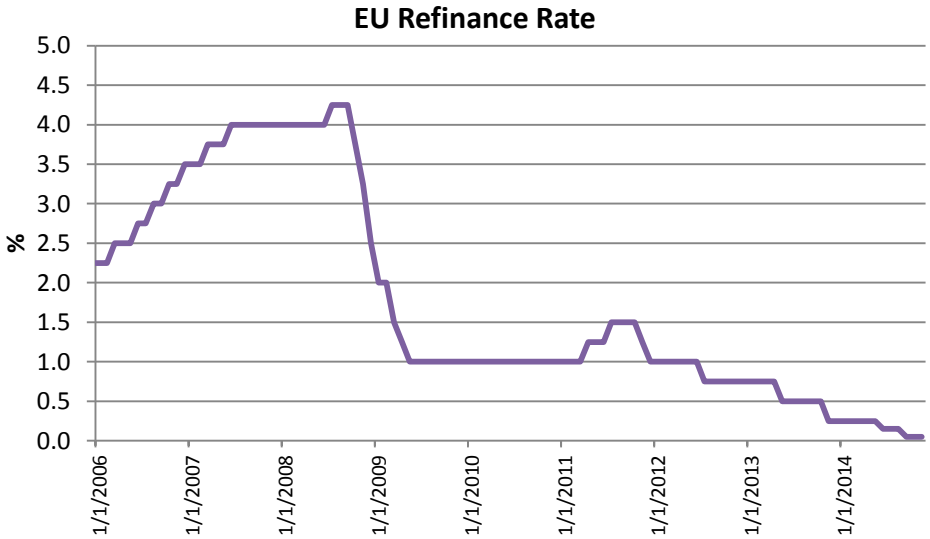
- Japan – Quantitative Easing
  - **The Bank of Japan (BOJ) is set to continue its QE programme and announced commencing 2015, the BOJ will increase its balance sheet by 15 percent of GDP per annum (US$ 700 bn) and will extend the average duration of its bond purchases from 7 years to 10 years**

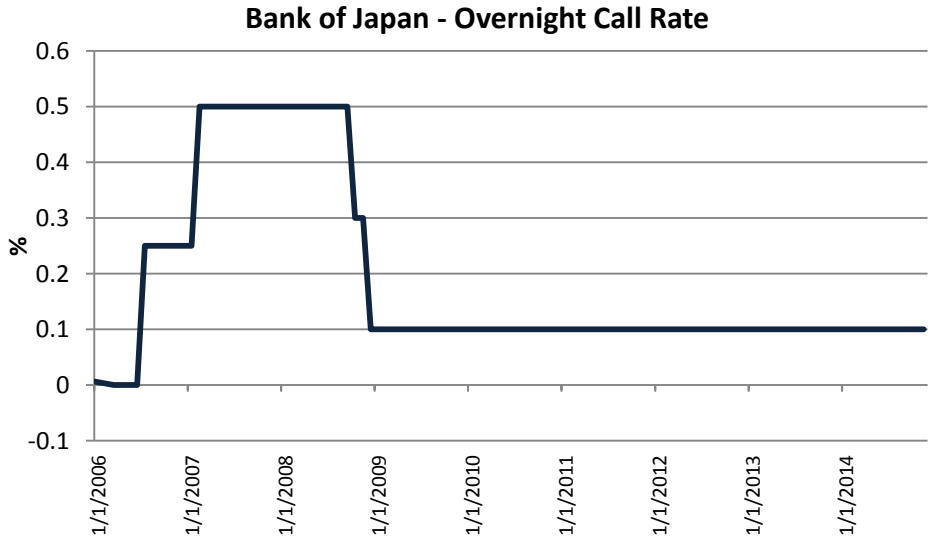
- China –Qualitative Easing
  - **The People's Bank of China (PBOC) reduced its benchmark one-year loan rate by 0.4 percentage point to 5.6% and cut its benchmark one-year deposit rate by 0.25 percentage point to 2.75% in November 2014**
  - **The Central Bank of China in September and October of 2014 launched a "medium-term lending facility", injecting around yuan 769.5 billion to the economy.**

Advanced economies are experimenting with near-zero interest rates…









Most EMs have improved their macroeconomic management during the last decade increasing their ability to access international capital market…

- **Major improvements include;**
  - Higher and sustainable growth rates and rising per capita incomes
  - Lower inflation
  - Higher investment
  - Better fiscal management
  - Better debt management
  - Increasing external reserves by generating surplus in BOP
  - Improved sovereign ratings

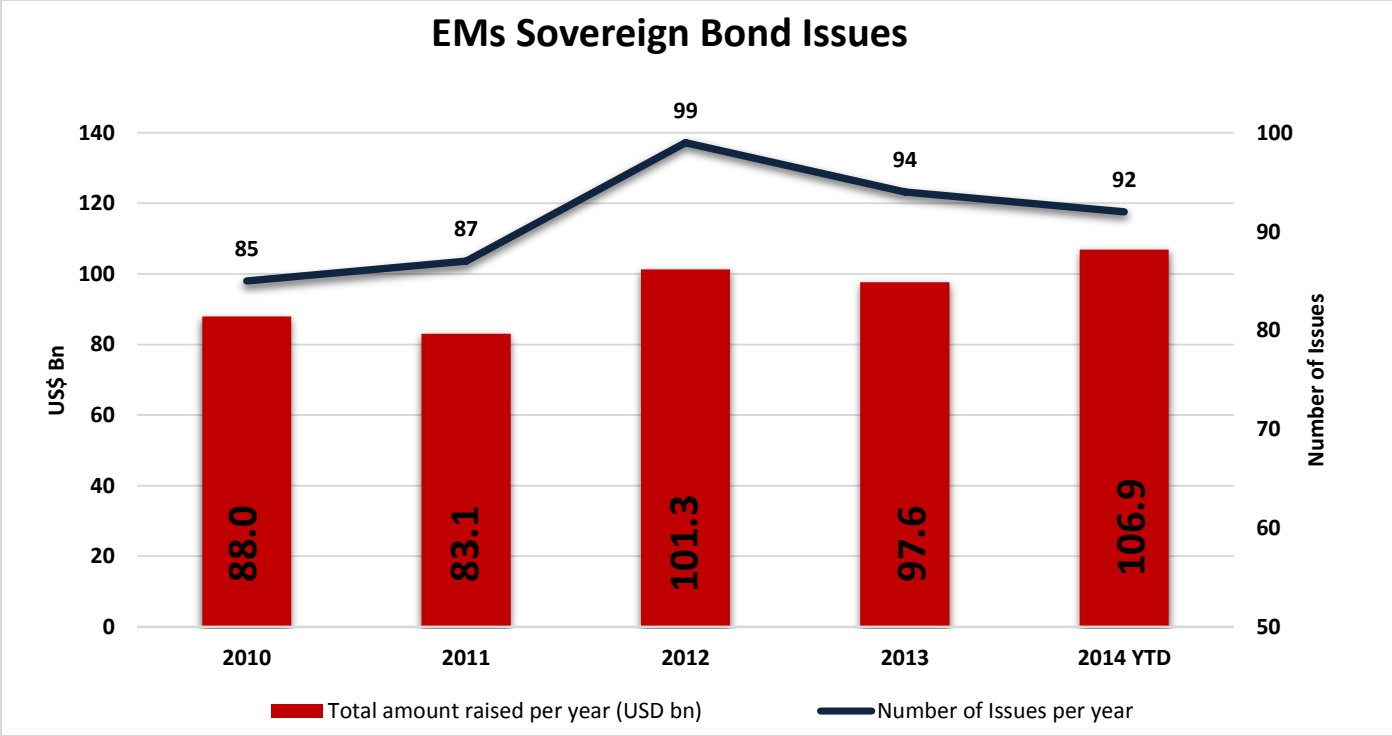
Most EMs improved the supply-side of debt management too…

- Mainly improving risk management;
  - Lowering Rollover risk by extending the maturity profile
  - Lowering market risk by reducing floating rate debt
  - Lowering debt stock by improving fiscal operations

- Improving infrastructure for secondary market operations
- Strengthening the public sector balance sheet making more resilient to market shocks (interest rate and exchange rate risks)
- These improvements have further encouraged foreign investors to invest in EMs securities

EMs sovereign bond issuances in international capital market increased during the post GFC period…

- More EMs joined the "International borrowers' club" to raise cheap funds
- Size of the issue and number of issuances gradually increased
- EMs borrowings of US$ 500 bn from international capital market during 2010-2012 period (IMF estimates)



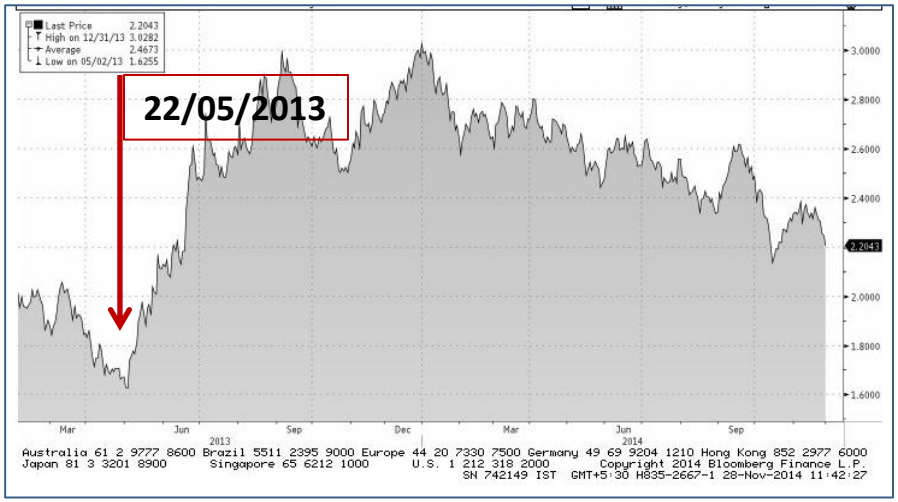
Demand-side factors also contributed to the rapid increase of EMs borrowings…

- Fund managers in international capital markets are searching for higher yields as yield in AEs are at near zero levels
- Central Banks running with excessive reserves are diversifying portfolios
- Encouraging EMs to access cheap funds by investors/international banks/advisers

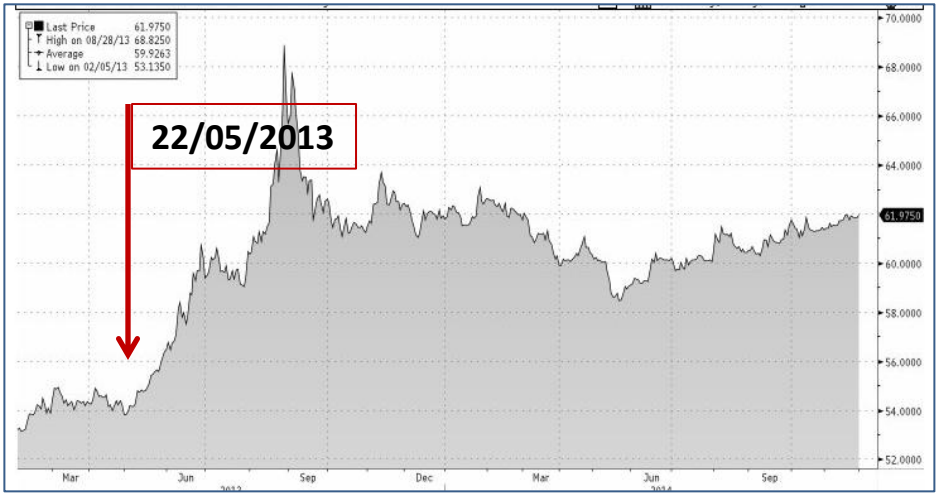
But, Fed Tapering led to substantial turmoil in the international capital market…

- US dollar and US Fed rate are still playing a benchmark role in international capital market
- Ben Bernanke's statement on the plan of tapering on 22 May 2013
- Immediate response of adjusting interest rates upwards in global markets
- Severe impact on some of EMs

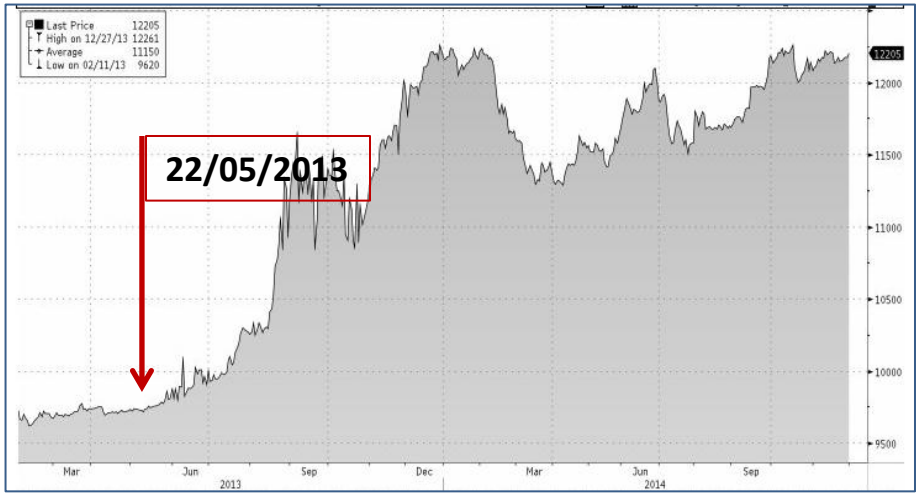
The yield – 10 yr US Treasury bonds



The Indian rupee (INR/USD)



The Indonesian rupiah (IDR/USD)



2. The Case: Sri Lanka

Sri Lanka too brought in prudent policies in sovereign debt management in the last decade…

- More dynamism to the secondary market development;
  - Scriptless Securities Settlement System (SSSS)
  - Real Time Gross Settlement (RTGS) System
  - Lowering fragmentation in the government securities market
  - Improved Primary Dealer system
  - Pre announcement of the auction calendar
  - Electronic trading system
  - Narrowing trading spread
  - Introduce necessary regulations for efficient market operations
  - Expansion of the investors base
  - Tax free secondary market operations
  - More issues of on-the-run bonds at the primary market
  - Develop a more active yield curve
  - Continuous awareness campaigns
  - Electronic Trading Platform with Bloomberg (soon)

Sri Lanka too brought in prudent policies in sovereign debt management in the last decade…(cont.)

- Brought in sovereign rating process by inviting all three Ratings agencies (S&P, Moody's, Fitch)
- Prudent risk management practices
  - Lowering rollover risk by extending maturities up to 30 years
  - Reducing interest rate risk by reducing index bonds and short term debt
  - Lowering exchange rate risk through improved macro management
- Lowering borrowing through fiscal consolidation
- Expand the investor base, both local and foreign

Main drivers encouraging SL to access the international capital market are…

- To maintain high investments and high growth rates
- To crowd-in private investment
- Declining concessionary funding from multi/bi-lateral sources
- Improved macroeconomic conditions
- Improved sovereign ratings
- Limited resources in the local market at reasonable rates
- Availability of cheap funds in international capital markets
- Ability to raise funds from international markets at reasonable costs
- Improvement of the pay-back capacity of the country

SL government has entered the International capital market through…

- **Issuing sovereign bonds (foreign currency) in the international capital market from 2007**

and

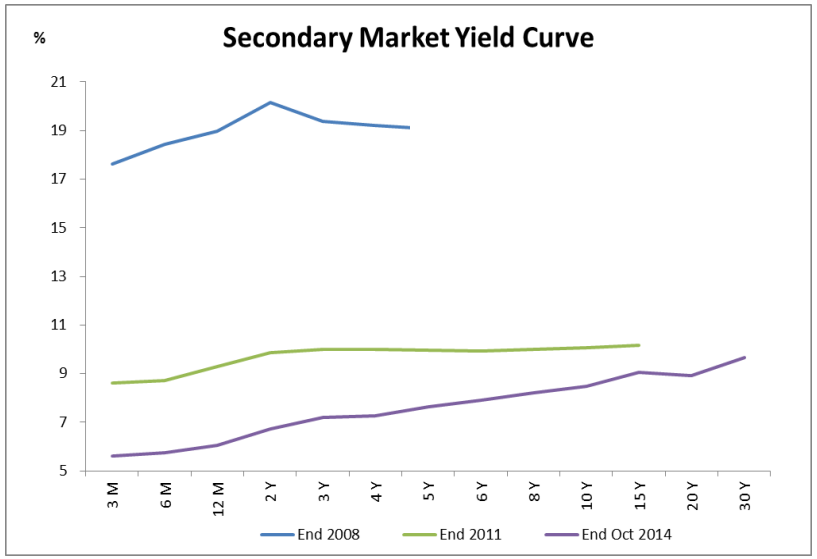
- **Opening local currency denominated securities market for foreign investors from 2006**

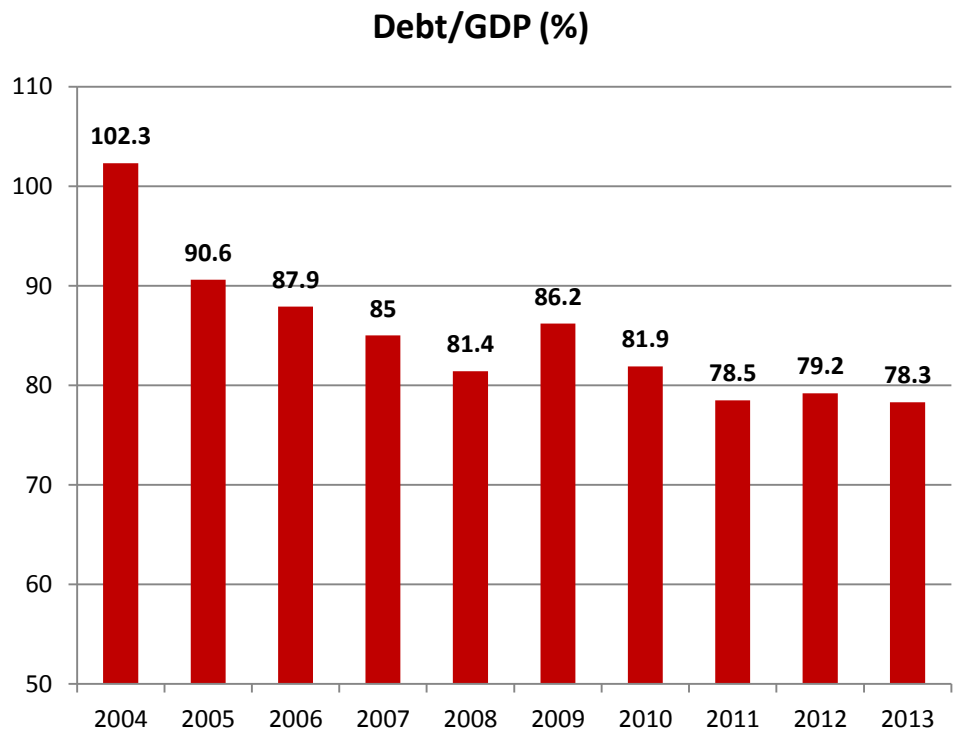
SL reported significant improvement in debt management in the recent past…

Domestic

- Gradual increase of maturity profile of Treasury bonds up to 30 years
- Sharp Increase of ATM of domestic debt portfolio
- Yield curve extended and downward shifted
- Debt burden was substantially reduced

Year	2008	2010	2014
ATM (yrs)	2.17	2.10	5.97





SL successfully managed sovereign bond issues in the international capital market…

- **Extending the maturity and lowering the cost of borrowing in international bond issues**

Year of Bond issue	Size (US $ Mn.)	Term (Yrs)	Yield (%)
2007	500	5	8.250
2009	500	5	7.400
2010	1000	10	6.250
2011	1000	10	6.250
2012	1000	10	5.875
2014	1000	5	6.000
2014	500	5	5.125

SL Expanding the international investor base and access all key international markets…

- The format of all sovereign bond issues were Reg. S/144A type approaching global investors

Year of Bond issue	No. of Global Investors*	Regional Share (%)*			Type of investors*		
		Asia	Europe	US	Fund Managers	Banks	Others
2007	135	30	30	40	n.a	n.a	n.a
2009	269	24	31	45	78	8	14
2010	362	23	25	53	85	8	7
2011	315	27	30	43	86	8	6
2012	425	27	29	44	90	6	4
2014	287	32	22	46	81	14	5

* At primary issues

SL opened the local currency debt market too for foreign investors with a cap…

- Gradual opening process;
  - Initially opened only 5% of T-bond market in 2007
  - T-bill market opened in 2007 limited to 5%
  - Increased the cap to 10% in 2009 after careful risk assessment
  - Since 2011, cap limited to 12.5%
- Strict policy to keep cap at low and manageable level despite heavy demand from foreign investors
- Close monitoring and managing process
- Discouraging “hot money” type investors
- No significant outflows even after the announcement of US Tapering and sharp reduction of interest rates in the local market

3. Final Remarks

Debt managers need prudent systems to manage demand side risks…

- Demand side factors are beyond the control of debt managers
- Major demand side risks include;
  - Rollover risks
  - Interest rate/exchange rate volatility
- Pre-mature withdrawals disturbing both;
  - Yield curve in local currency market
  - Pressure on exchange rate in local forex market

Managing demand side risks need…

- Need more cautious approach of issuing sovereign bonds and opening local currency G-sec to foreign investors
- Maintaining external short term exposure at tolerable level
- Maintaining sufficient levels of liquidity in the secondary market (vibrant secondary market)
- Improve absorption capacity of the forex market
- Close monitoring mechanisms for inflows/outflows
- Better understanding about the type of investors in the portfolio
- Expand and diversify the investor base
- Regular investor updates and close dialog with global investors
- Proper assessment about risk absorption capacity of the local economy (tolerance level)
- Build-up spaces in all sectors in the economy to absorb shocks

Thank You